MEMORANDUM OF LAW

DATE: February 7, 1986
TO: Bruce Herring, Risk Management Director via
John Fowler, Deputy City Manager
FROM: City Attorney
SUBJECT: Supplemental Pension Savings Plan Compliance
with the Retirement Equity Act

In a recent memorandum, you asked this office to respond to several questions concerning changes in the administration of the Supplemental Pension Savings Plan (SPSP) which have occurred as a result of recent amendments to the Plan Document. These changes were made upon the advice of the City's consultant in order for the plan to comply with certain provisions of the Retirement Equity Act of 1984 (REACT) (Public Law 98-397, 98 Stats. 1426 (1984)) and the Deficit Reduction Act of 1984 (DEFRA) (Public Law 98-369, 98 Stats. 497 (1984)).

Section 10.02(b) of the Plan Document now requires the Plan Administrator to determine whether or not a domestic relations order issued by a court represents a "qualified domestic relations order" as that term is defined in Sec. 414(p) of the Internal Revenue Code of 1954, as amended. During the period of time it takes the Plan Administrator to make this determination, certain procedural steps must be followed. In addition, the Plan Document has also been amended to provide that in the case of a married participant's retirement or other termination, the normal form of benefit will be a "qualified joint and survivor annuity."

At the present time, the City has made an application to the Internal Revenue Service for an advanced determination that the SPSP plan meets the qualifications of 26 USC 401(a) with respect to its continued qualification. We feel confident that this determination will be favorable as we believe SPSP is a qualified governmental plan as that term is defined in 26 USC 414(d). However, as we have previously indicated to you in a Memorandum of Law dated October 15, 1985, SPSP is a "governmental plan" under 29 USC 1003 and therefore exempt from the funding and vesting provisions of the Employee Retirement Income of Security

Act of 1974 (ERISA) (Public Law 93-406, 93 Stats. 691 (1974)) which REACT amended. Evidently, as a result of the flurry of amendments to the Internal Revenue Code contained in REACT and DEFRA, our consultants believed that it was in the City's best

interest to adopt certain provisions of REACT which are inapplicable to the City into the SPSP Plan Document. It is now clear, however, that the City was not required by law to adopt REACT's provisions relating to "qualified domestic relations orders". These provisions are found in Sec. 204 of REACT and amend 26 USC 401(a)(13) and 26 USC 414(p). These amendments to the anti-assignment provisions of 26 USC 401(a)(13) do not apply to governmental plans according to an IRS Letter Ruling of June 27, 1984, and an IRS General Counsel Memorandum of August 20, 1984. The General Counsel memorandum states in part:

> The flush language of Sec. 401(a) appearing after Sec. 401(a)(24) provides in pertinent part that Sec. 401(a)(13) applies only to a plan which Sec. 411 applies (without regard to Sec. 411(e)(2)).
>
> Section 411(e)(1) exempts governmental plans described in Sec. 414(d) from the provisions of Sec. 411 other than Sec. 411(e)(2). The governmental plan as described in Sec. 414(d) includes one established and maintained for its employees by the government of any state or any agencies or instrumentality thereof.

The requirement to provide joint and severable annuities for married participants is found in 26 USC 401(a)(11). Subsection 26 USC 401(a)(11)(B) indicates that the provisions of that paragraph shall only apply to any defined contribution plan which is subject to the funding standards of Sec. 412. However, Sec. 412(h)(3) exempts governmental plans from the funding requirements. Therefore, the City was also not required by federal law to adopt these provisions.

To the extent that state law permits, The City of San Diego was free to adopt the new amendments and voluntarily comply with certain provisions of ERISA and REACT. However, because The City of San Diego is not bound by those provisions of federal law, we are faced with the arduous task of interpreting the amendments according to the federal statutory scheme and then reconciling them with applicable provisions of California law concerning public pensions and civil judgments which the City must follow.

Preliminarily, you should be aware that California Code of Civil Procedures Sec. 704.110 generally exempts public retirement benefits from judgment in civil cases, except that once the benefit or any part of it become payable to a person, it may be applied to the satisfaction of a judgment for a child or spousal support against that person. In addition, California Civil Code

Sec. 4351 provides that a support order is not enforceable against an employee's benefit plan unless the plan has been joined or is a party to the proceedings. In Re Marriage of Williams, 163 Cal.App.3d 753, 209 Cal.Rptr. 827 (1985). Therefore, the City must still comply in a timely fashion with lawful state court judgments and orders regardless of any procedural guidelines established by ERISA and REACT for qualified domestic relations orders which have been incorporated by The City of San Diego into the SPSP plan.

With the above background in mind, we answer your questions as follows:

QUESTION NO. 1

WHAT PROCEDURES SHOULD BE ESTABLISHED TO IDENTIFY A "QUALIFIED" DOMESTIC RELATIONS ORDER?

ANSWER

The Plan Administrator is charged under paragraph 10.02(b) of Article X of the Plan Document with determining whether or not a domestic relations order is a "qualified domestic relations order" as that term is defined in Sec. 414(p) of the Internal Revenue Code of 1954 or its successor provision.

However, the Plan Administrator need not determine if a domestic relations order meets all of the requirements and formalities set forth in 26 USC 414(p). The reason for this is clear. The City cannot refuse to obey a lawful order of a state court on the grounds that the plan participants have voluntarily adopted inapplicable procedural provisions of federal law into the plan. If The City of San Diego is properly joined and the order is valid under Code of Civil Procedure Sec. 704.110, the Plan Administrator must follow the order. In those cases where the City is not joined or the order appears to violate Code of Civil Procedure Sec. 704.110, the assistance of this office should be sought prior to making any payments.

However, because the Plan Administrator is charged under paragraph 10.02(b) of Article X of the Plan Document to determine whether or not a domestic relations order is a "qualified domestic relations order", as that term is defined in Sec. 414(p) of the Internal Revenue Code of 1954 or a successor provision, the Administrator should do the following:

(1) Notify the participant affected by the order and any designated payee under the order of receipt of the order (if you so desire you may enclose a copy of the order) by mailing the notice to the address on the order or if there is no address on the order, to the last known address.

(2) The notice should include a statement that the Plan Administrator is in the process of determining within a reasonable time whether or not it is a "qualified domestic relations order".

(3) During this reasonable period of time, the Plan Administrator should check the order to ensure that the City has been properly joined pursuant to Civil Code Sec. 4351 and that the order is only for spousal and child support in accordance with California Code of Civil Procedure Sec. 704.110.

(4) The Plan Administrator should act within a reasonable amount of time depending upon the terms of the lawful order, however, it should not exceed the 90-day provision of Sec. 10.02(b) of the Plan Document.

QUESTION NO. 2

WHAT APPROPRIATE LANGUAGE FOR THE REQUIRED NOTIFICATION TO THE PARTICIPANT AND ALTERNATE PAYEE IS REQUIRED UPON RECEIPT OF THE ORDER?

ANSWER

If the joinder provisions of Civil Code Sec. 4351 have been complied with, the participant and the payee should have been notified by the court of any order affecting the participant's SPSP account; however, the alternate payee may not have been notified. In addition, Sec. 10.02(b) requires that the notice be sent. Neither federal law nor state law requires or provides specific language for this type of notice. Nevertheless, we would advise you that such a notice should state that:

(1) A court order has been served on the Plan Administrator (a copy of it may be attached).

(2) That the Plan Administrator will determine within the applicable time period whether or not the order is a qualified domestic relations order.

(3) The participant has a reasonable period to comment on the determination.

(4) That the amount payable under the order has been segregated into a separate account which will continue to bear interest at the regular rate.

(5) That the Plan Administrator will properly notify the participant and any payee under the court order of the determination (this must be after the time period given to the participant for comment has expired).

QUESTION NO. 3

THE RETIREMENT EQUITY ACT REQUIRES THAT UPON RECEIPT OF A DOMESTIC RELATIONS ORDER AND

DURING THE TIME THAT THE ORDER IS BEING SCRUTINIZED TO DETERMINE IF IT IS QUALIFIED, FUNDS AFFECTED BY THE ORDER MUST BE SEGREGATED IN A SEPARATE ACCOUNT IN THE PLAN OR IN AN ESCROW ACCOUNT. FUNDS ARE CURRENTLY POSTED TO EACH PARTICIPANT'S ACCOUNT. WILL THIS, IN CONJUNCTION WITH FLAGGING THE PARTICIPANT'S FILE TO PREVENT PAYMENTS FROM THE ACCOUNT, SUFFICE? IF NOT, WILL THE SEGREGATED FUNDS BE AVAILABLE FOR INVESTMENT AND WILL THEY EARN INTEREST WHILE IN THIS SEPARATE ACCOUNT?

ANSWER

Section 10.02(b) of the Plan Document indicates that while the Plan Administrator is attempting to determine whether or not the order is a "qualified domestic relations order" the Plan Administrator shall cause the amount otherwise payable under the order to be segregated in a separate account. In the event the Plan Administrator receives an order, joinder, summons or other notice of legal action which may result in a qualified domestic relations order, the Plan Administrator may, if not prohibited by a lawful court order, withhold payment from the plan beyond the date such payment would be normally distributed up to a maximum of ninety days. During this period of time, merely flagging a participant's account will not suffice as Sec. 10.02(b) clearly dictates that the Plan Administrator must segregate in a separate account in the plan the amounts otherwise payable under the order. Neither federal or state law requires that the funds be actually removed from the investment portfolio but only that a separate accounting be made. Interest at the normal rate is earned during this period.

QUESTION NO. 4

IT HAS BEEN OUR UNDERSTANDING THAT BENEFITS WOULD NOT BE PAID TO AN ALTERNATE PAYEE UNTIL SUCH TIME AS THEY WOULD BE PAYABLE TO THE PARTICIPANT UPON TERMINATION OR RETIREMENT, EXCEPT THAT IN THE CASE OF A DEFINED CONTRIBUTION PLAN (SPSP) THE ORDER MAY REQUIRE PAYMENT TO BE MADE TEN YEARS PRIOR TO THE NORMAL RETIREMENT DATE.

(A) PLEASE DEFINE NORMAL RETIREMENT DATE; (B) IF THE NORMAL RETIREMENT DATE IS THE PARTICIPANT'S AGE 65 AND A QUALIFIED DOMESTIC RELATIONS ORDER IS RECEIVED AT THE

PARTICIPANT'S AGE 25, WOULD PAYMENT BE WITHHELD UNTIL THE PARTICIPANT REACHED AGE 55 ASSUMING THE PARTICIPANT CONTINUED HIS CITY EMPLOYMENT? IF SO, MUST MONIES DUE THE ALTERNATE PAYEE CONTINUE TO BE MAINTAINED IN A SEGREGATED ACCOUNT DURING THAT TIME? IS ACCRUED INTEREST ADDED? (C) SINCE SPSP ALLOWS WITHDRAWAL OF VOLUNTARY CONTRIBUTIONS BY AN EMPLOYEE WHO IS 40%-100% VESTED, SHOULD MONEY, WHICH IS AVAILABLE FOR WITHDRAWAL BY THE PARTICIPANTS BE PAID TO THE ALTERNATE PAYEE AS IT BECOMES AVAILABLE? IF WITHDRAWAL IS MADE BY A PARTICIPANT WHO IS LESS THAN 100% VESTED, THE CITY'S MATCHING CONTRIBUTIONS ARE FORFEITED. HOW WOULD PAYMENTS TO AN ALTERNATE PAYEE AFFECT CITY MATCHING CONTRIBUTIONS AND THE EMPLOYEE'S RIGHTS TO THOSE CONTRIBUTIONS?

ANSWER

The term "normal retirement date" is not defined in the Plan Document, REACT or ERISA. However, the term "normal retirement age" is defined in Sec. 114 of the Plan Document as "the earlier year of the participant's 65th birthday or the date upon which benefits commence under The City of San Diego's Employee Retirement System.

Subquestions (B) and (C) are based on the assumption that the SPSP program is governed by provisions of ERISA which we have already indicated is not the case. The City of San Diego is only bound by those provisions which we have voluntarily adopted. The provisions of REACT which apply to domestic relations orders also

ensure that they must be valid under state law. California Code of Civil Procedure Sec. 704.110 entitled "Public Retirement Benefits; Rights and Benefits Under Public Retirement System Return of Contributions from Public Entity" is very specific concerning the procedure that public entities must utilize before any amounts held, controlled or in the process of distribution by a public entity, derived from contributions by the public entity or by any officer or employee of a public entity for public retirement purposes, are distributed pursuant to a judgment for child or spousal support against that person. It is very clear that a valid state domestic relations order can permit payments to be made in satisfaction of a judgment for child or spousal support only when the amounts become payable to the plan participant. Except for payments provided by a qualified joint or survivor annuity (which we will discuss later) the SPSP plan

does not provide for periodic payments. Therefore, any valid domestic relations order issued against a current employee can only reach funds which the participant has attempted to voluntarily withdraw from the plan. If you receive any order that attempts to reach funds within a participant's account not eligible or selected for withdrawal, you should notify this office as soon as possible.

QUESTION NO. 5

IF A PARTICIPANT IS LESS THAN 100% VESTED, COULD A QUALIFIED ORDER SPECIFY PAYMENTS OF MONEY POSTED TO THE PARTICIPANT'S ACCOUNT, BUT IN EXCESS OF THE PARTICIPANT'S VESTED INTEREST IN THE ACCOUNT? IF SO, WHAT HAPPENS IF THE EMPLOYEE TERMINATES BEFORE BECOMING VESTED IN THE EXCESS AMOUNT?

ANSWER

The answer again is found in California Code of Civil Procedure Sec. 704.110. A court order which provides for payments from the employee's account would not be in compliance with that section and would therefore not be a qualified domestic relations order.

QUESTION NO. 6

IF THE COURT ORDER IS DETERMINED TO LACK THE REQUIRED ELEMENTS FOR A QUALIFIED DOMESTIC RELATIONS ORDER, WHO (IN ADDITION TO THE PARTICIPANT AND THE ALTERNATE PAYEE) SHOULD BE NOTIFIED AND IN WHAT MANNER?

ANSWER

The Plan Administrator need only notify the participant and each alternate payee as indicated in the court order of such determination to be in compliance with the provisions the City has adopted. We would recommend that the participant and each payee be notified by letter sent to the address indicated on the order or if none is indicated to the last known address.

QUESTION NO. 7

THE RETIREMENT EQUITY ACT REQUIRES THAT THE NORMAL FORM OF BENEFIT FOR A MARRIED PARTICIPANT SHALL BE A QUALIFIED JOINT AND SURVIVOR ANNUITY. A PARTICIPANT, WITH SPOUSAL CONSENT, CAN ELECT A LUMP SUM PAYMENT OR A LIFE ANNUITY. NORMAL FORM OF BENEFIT FOR AN UNMARRIED PARTICIPANT CAN BE A LUMP SUM PAYMENT IN CASH WITH THE OPTION OF A LIFE ANNUITY. WE PRESENTLY REQUIRE PARTICIPANTS

WHO WANT AN ANNUITY TO TAKE A LUMP SUM PAYMENT AND PURCHASE THE ANNUITY FROM A PROVIDER OF THEIR CHOICE. OUR CONCERN IS THAT THIS MAY NOT MEET THE REQUIREMENTS OR INTENT OF THE RETIREMENT EQUITY ACT. IF NOT, WHAT ARRANGEMENTS MUST WE MAKE FOR PROVIDING THE ANNUITY?

ANSWER

Again, you are only bound by those provisions of REACT which the City has specifically adopted and not by any other provisions concerning qualified joint and survivor annuities. Section 9.01(b) indicates that the normal form of benefit for a married participant in the plan shall be a qualified joint and survivor annuity. That clearly means that The City of San Diego must provide the annuity. To require an employee to take his money in cash and then purchase an annuity may cause the employee to incur a taxable event. Therefore, it appears that The City of San Diego must provide this annuity. We suggest that the City make available to the participant a choice of annuities from various companies and that prior to distribution of the benefit the participant be required to elect one or to pick the optional form of benefit described in paragraph 9.02 of the Plan Document, which is a lump sum benefit.

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By
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